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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

BRIEF IN OPPOSITION OF MOTION TO DISMISS OR AFFIRM

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Pursuant to Rule 16(d)(4) of this Court, Appellant submits this Brief in opposition to Appellee's motion to dismiss or affirm.

STATEMENT

The Statement in Appellant's Jurisdictional Statement (pp. 4-6) presents a fair and impartial narrative of the facts, reduced in scope to a bare minimum.

In Appellant's Brief, filed with the Supreme Court of South Carolina, there appears a category titled "Undisputed and Uncontradicted Facts." These appear in said Brief at pp. 2-7. Because of the obvious impact and bearing that these facts should and must play and also the importance that must be given to them in the matter of

Appellant's proof of the unconstitutional exaction of taxes from an interstate business, they are reproduced hereinbelow:

UNDISPUTED AND UNCONTRADICTED FACTS

1. Appellant is a New York corporation, is a converter of drapery, slipcovers and upholstery fabrics and, as such imports griege goods (raw materials) from about ten foreign countries, which goods reach the United States at ports of entry located at Norfolk, Virginia, New York City, and Charleston, South Carolina. Appellant contracts, for a fee, with approximately six independent plants to do the finishing work on the raw goods, these plants being located in Adams, Massachusetts, Gaffney, South Carolina and Cherokee, North Carolina, none of which are either owned, operated or controlled by Appellant. Additionally, Appellant also buys some unfinished goods from manufacturers located in several states including South Carolina. (Ff. 93-98, 185.)

2. Appellant's headquarters are in New York City where it occupies three levels of space (approximately 15,000 square feet) at the corner of 29th Street and Fifth Avenue in the building at 267 Fifth Avenue, where, twice each year, Appellant's business operations begin anew with the planning of a line of goods to be offered to its customers. In its New York headquarters, a staff of about eight Designers and Artists plan about 150 patterns a year with 40 to 60 patterns for each seasonal line. This planning involves a selection of woven goods, and determining, designing and adapting the coloring of patterns to be sent to the aforementioned independent contracting finishers and printers to whom Appellant pays a fee for this service. (Ff. 226, 94, 95, 182-185, 98, 97.)

3. When the line is planned in New York, then the griege goods (raw materials) are purchased, consisting of about seven million yards bought from various companies, like J. P. Stevens, Burlington, Graniteville and various others. About four million yards are bought and imported from overseas through the ports at Norfolk, New York City and Charleston, South Carolina. Additionally, about one million yards of goods, already finished in accordance with Appellant's design, are bought direct from plants like Burlington and J. P. Stevens and others. (Ff. 94, 177-180, 185.)

4. All of Appellant's executive, management and administrative personnel are located in its New York headquarters. All orders taken by Appellant's salesmen are sent to New York where they are handled by about fifteen clerks, each of whom, at some point, handles each other. One will add to or reduce inventory entries, as all inventory records are kept solely in New York. Another clerk will make up commission sheets. Others will prepare invoices, prepare packing orders, handle volumes of correspondence, etc. (Ff. 107, 105, 167-173.)

5. A review made in New York headquarters every day of inventories of this business, is of first importance to determine when to add additional goods by having them converted, printed, woven or finished. (F. 170.)

6. No employees outside Appellant's New York Office have any say whatever in the operations or in the completion of the stock or anything that is done in Appellant's converting business. (F. 173.)

7. All billings, advertising programs, purchasing and planning are prepared and done in New York. A Credit Manager and his assistants, all of whom are located in New York, perform credit checks and related work there. (Ff. 166-173.)

8. Appellant itself does no manufacturing anywhere. In addition to its headquarters in New York City, it maintains an office and showroom in Chicago and in Los Angeles. It employs ten commission salesmen who reside in seven different states (none of which is South Carolina), and these ten salesmen call on customers in forty-nine states and Canada. Additionally, an Export Manager, whose headquarters is the New York City location of Appellant, handles,

along with his staff, ten to fifteen foreign representatives, with customers in at least ten foreign countries overseas. (Ff. 107, 102-103, 182-184, 211.)

9. The ten commission salesmen handle no other lines than Appellant's. They cover their complete territory twice each year. The salesman who has South Carolina resides in Greensboro, North Carolina, and he calls on customers in Florida, Alabama, Georgia, North Carolina and South Carolina. He carries ten cases of samples of about 450 designs. His South Carolina customers, the number being so small, require only about two days per season or four days per year in South Carolina, actual sales to South Carolina customers amounting to only slightly over 1% of total sales. (Ff. 205-210, 223, 235-238.)

10. In addition to calling on customers to sell, it is the duty of a salesman of Appellant to call upon customers who are delinquent in their accounts, to service those accounts, and to try to collect them. Otherwise, all payments for goods are made by the purchaser directly to Appellant's New York headquarters. (Ff. 225, 241-244.)

11. Appellant maintains no office of any kind in South Carolina. It has made no capital investment in South Carolina. It does no manufacturing in South Carolina. It owns no manufacturing plant in South Carolina. It has no executive or management personnel in South Carolina. (Ff. 103, 106.)

12. Appellant's customers are retailers and have remained rather steady and constant during the years in controversy. They include Sears Roebuck, J. C. Penney, Montgomery Ward, R. H. Macy and about every jobber in the country including David and Dash in Miami, Roman in New York, Jack H. Pearl on the West Coast, Pearlstine Company in Seattle, Reese B. Davis in Dallas, Richardson in Atlanta, and Groom and David in New York. (Ff. 229, 273-274.)

13. The Appellant only maintains a rented warehouse in South Carolina and nothing else. It is staffed by thirty to forty employees, all of whom are laborers

except a superintendent and two secretaries, all performing solely a warehousing function. (Ff. 109-110, 191-193.)

14. Prior to Appellant's renting the warehouse space at McColl, the printers and finishers, to which Appellant regularly sent its raw goods for that purpose, left the finished goods in cases after their converting work was completed, and they shipped the goods to the buyers. There was no warehouse maintained for shipping at all. It was what is called a "drop shipment operation". Appellant paid the printers and finishers a fee for this service. (Ff. 443-471.)

15. As a part of the processing of its salesmen's orders, the New York headquarters of Appellant prepares and sends to Appellant's rented warehouse at McColl, S. C. packing orders, setting out instructions for the laborers, known as "pullers", who pull goods from warehouse bins according to the pattern, color and quantity (number of pieces) designated on the packing orders made up in New York. The laborers put the assembled goods on dollies that move them to the packing line. There, the laborers wrap the goods in paper or put them in cartons, tied with twine or metal strapping. (Ff. 122-125.)

16. A bill of lading is prepared for each package and is attached when the goods are placed on the shipping platform to be picked up by a common carrier for delivery to the purchaser at his address. Two copies of the bill of lading are delivered to the trucker and two copies are sent to Appellant's New York office by McColl warehouse. Ff. 125-126, 194-198, 233-234.)

17. Ultimately, that is as it turned out, only three states, namely, New York, California and South Carolina either imposed income taxes or corporate license fees upon Appellant for the years involved or made claim for the same. (Ff. 279-281, 477, 45.)

18. During the years involved in this controversy, Appellant carried blanket or omnibus insurance coverage over goods in transit from its McColl, S. C. warehouse to the purchaser in the total amount of

$3,500,000.00 with liability for any single loss limited to $50,000.00. The premium on this policy costs Appellant the sum of $16,000.00. (Ff. 129-150, 158-166.)

19. Respondent admitted that it arrived at the approximate 84% of all sales everywhere as being reasonably attributable to South Carolina by examining Appellant's tax returns to the other two states, California and New York. In so doing Respondent's field agent saw that Appellant had not been taxed on 100% of its income and he believed therefrom that South Carolina would be demanding a reasonable allocation to it by raising the sales factor to approximately 84% of all sales everywhere. (Ff. 499-526, 489-491.)

20. Respondent testified that before its adjustment to the tax returns of Appellant, approximately 29% of Appellant's income was allocated to South Carolina, and that about 57% of Appellant's total income was being allocated to all three states of New York, California and South Carolina. (Ff. 490-491.)

21. It was admitted by Respondent that after it made its reassessment of Appellant's tax liability to South Carolina, the percentage of Appellant's income claimed by South Carolina was about 55.5%. It was further testified by Respondent's sole witness, its field agent, who did not qualify as an expert, that after its reassessment, all states taxed 83% of Appellant's entire income and he laid emphasis on the fact that Appellant had not been taxed on 100% of its income, and because of that he considered that the reassessment he made was reasonable. (Ff. 502-526.)

QUESTIONS PRESENTED

The questions have been impartially and fairly presented in the Jurisdictional Statement (p. 4). There are obviously substantial Federal questions, both constitutional and statutory.

ARGUMENT

I

Introductory

Appellee will likely contend that this appeal should be dismissed, and, as customary in such Motions, will doubtless raise the principle that the decision of the Supreme Court of South Carolina should not be reviewed because it is allegedly based upon an independent, non-federal ground. This principle is found in *Fox Film Corporation v. Kentucky,* 296 U. S. 207, 56 S. Ct. 183. Such an argument is untenable here as the Supreme Court of South Carolina (Jur. Statement, pp. 17-24) based its decision on Federal grounds. Federal law was stated to have been considered by that Court, was cited by that Court, and formed the only basis for its decision.

This appeal involves the **novel** question of the constitutionality of a "throw-back" of the sales factor of a state income three-factor apportionment or allocation provision.

II

Apportionment of interstate income must not exceed that which reasonably relates to extent of business activity of Appellant within taxing state in terms of factual proof.

If indeed the law today is as this Court has uniformly held, that is, that a state cannot constitutionally allocate to itself for purposes of taxation of a unitary or interstate business net income beyond that which reasonably represents the extent of activity of that taxpayer within the taxing state, then, certainly an exaction is neither made reasonable nor constitutional, but to the contrary is made both more unreasonable and unconstitutional when, as here, the allocation was raised by Appellee from the 29% of total net income, voluntarily allocated by Appellant, to 55.5% of the entire net income by claiming and allocating

sales in states that had not taxed but which were, nevertheless, *"taxable"* there. Throughout the history of this particular case, Appellee has openly admitted that the 55.5% which it claimed, was arrived at by including sales made in the state of the purchaser.

III

Supreme Court of South Carolina erred in holding Appellee can tax, as its own, sales in states of the purchasers where proof showed activity in those states exceeded protection afforded by Federal Statute (15 U.S.C. 381, et seq.).

The sales were proven by Appellant to be *"taxable"* in the states of the purchasers. There was not the slightest evidence offered by Appellee to contradict that proof.

Public Law 86-272, 15 U. S. C. 381, is designed to permit those states of the purchasers the right to tax net income, but nevertheless reasonably and constitutionally, if the activities of the taxpayer in those states of the purchasers exceed the bare solicitation of orders in those states. That law (Public Law 86-272, 15 U. S. C. 381) does not specify either that if those states did not, in fact, *"tax"* or that if the taxpayer *"had not been taxed"* in the state of the purchasers, Appellee can then, nevertheless, claim those sales in such states as its own under the guise of an exaction that bears a reasonable relation to the extent of business activity of the taxpayer within South Carolina. Such makes a mockery out of the federal law and the Constitution.

The S. C. Supreme Court, pp. 6-7 of the Jurisdictional Statement, disregarded the evidence and held, contrary to interpretation given to Public Law 86-272, 15 U. S. C. 381, by the highest courts of the several states, (Jurisdictional Statement, p. 8) that "the corporation in these periods was 'taxable' only in three states: New York,

California and South Carolina." The evidence showed that while the Appellant *"had not been taxed"* except by those three states, but at the same time the evidence clearly showed that Appellant was *"taxable"* in the other states of the purchasers on sale made there because its activity therein uniformly exceeded the protection afforded by Public Law 86-272, 15 U. S. C. 381. (Jurisdiction Statement, p. 10.)

IV

South Carolina Supreme Court ignored facts either admitted, undisputed and/or proven as to real minimal activity of Appellant in South Carolina, showing unconstitutional exaction by Appellee.

Apart from the most important interplay of Public Law 86-271, 15 U. S. C. 381, the decisions by this Court dealing with state taxation of net income of a unitary business, beginning with *United States Glue Co. v. Oak Creek,* 247 U. S. 321, 38 S. Ct. 499, and later in *Shaffer v. Carter,* 252 U. S. 37, 40 S. Ct. 221; *Travis v. Yale and Towne Manufacturing Co.,* 252 U. S. 60, 40 S. Ct. 228; *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 113, 41 S. Ct. 45; *Bass, Ratcliff and Gretton v. State Tax Commission,* 266 U. S. 271, 45 S. Ct. 82; *State, ex rel. Maxwell v. Kent-Coffey Mfg. Co.,* 204 N. C. 365, 168 S. E. 397, aff. 291 U. S. 642, 54 S. Ct. 437 and enunciated in *N W. States Portland Cement Co. v. State of Minn.,* 358 U. S. 450, 79 S. Ct. 357, have uniformly held that a state net income tax is not unconstitutional unless it is not properly apportioned to local activities within the taxing state.

The above stated principle of law, so well established by decisions of this Court, is meaningless if it is to be applied summarily without regard to proven facts and in face of overwhelming undisputed and uncontradicted facts, disclosing an activity of the taxpayer in South Carolina so

minimal that Appellant can abandon that South Carolina minimal activity without any disruption by either again adverting to "drop shipments," requiring no rented warehouse, or by renting a warehouse in a state without an income tax law.

Despite the fact that Appellee will argue in its Motion that there was sufficient activity by Appellant in South Carolina to cause the Appellee to claim 84% of all sales, the proven facts completely disprove this argument inasmuch as the argumnet is one of a principle of law rather than the application of that principle of law enunciated by this Court measured in terms of the proven facts. The proven facts show that applying the principle of law laid down by this Court as a guideline to those facts, the sanctioning by the South Carolina Supreme Court of an apportionment to Appellee of 84% of all sales violates the Commerce Clause of the U. S. Constitution, Article 1, Section 8, and also violates Section 1 of the Fourteenth Amendment to the U. S. Constitution.

Appellant has shown by competent, unbiased, clear and cogent evidence, including that of an independent certified public accountant who qualified as an expert witness and who was not connected with the business, that the apportionment formula as applied to it by Appellee has resulted in extra-territorial values being taxed. The required burden of proof has been met by Appellant.

An unfortunate course or trend came about through the years following the 1934 decision in *State, ex rel. Maxwell v. Kent-Coffey Mfg. Co.,* 204 N. C. 365, 168 S. E. 397, aff. 291 U. S. 642, 54 S. Ct. 437. The decision of the Supreme Court of North Carolina was affirmed. The Supreme Court of North Carolina, in denying taxpayer's attack on the apportionment of income to North Carolina on constitutional grounds, differentiated this case from the earlier decision of *Hans Rees' Sons v. North Carolina,* 283 U. S. 123, 51 S. Ct. 385, where the allocation was declared unconstitutional as applied to that taxpayer. The distinction drawn by the Court was that in *Hans Rees'* the taxpayer was able to separate the business into its separate component parts, whereas in *Kent-Coffey* the taxpayer failed to do so.

It is submitted that if a business is, in fact, unitary, then it is impossible to separate it into component parts for allocation purposes. In fact, this was recognized by the North Carolina Supreme Court and was stated in the *Kent-Coffey* Opinion itself. Thus, *Hans Rees'* was not a unitary business in the first place under the reasoning of the North Carolina Supreme Court.

In view of the complete inability of any corporate taxpayer to break up a purely unitary business into its separate component parts, does that mean that every allocation or apportionment made by a state in asserting a tax on net income is not in violation of either the Commerce clause or the Fourteenth Amendment irrespective of the glaring inequity implicit in such allocation? The trend today is to be faced with a situation where irrespective of the proven minimal activity within a taxing state as compared to activity of the unitary taxpayer everywhere, nevertheless, there follows a finding that the taxpayer, having failed to break up the business into its component parts, the apportionment, however ridiculous, must stand.

It is submitted that there must be a way apart from being able to break up a unitary business into its component parts, which is not even possible in the first instance, whereby a taxpayer can get relief from an unconstitutional assessment of a net income tax. It is submitted that that way is to prove by competent evidence that the formula, as applied to it, produces a result that is not reasonably related to the business activity carried on by the unitary taxpayer in the taxing state. This Appellant has done that

by competent proof. There was no testimony or proof on the part of Appellee that contradicts that proof of Appellant.

Counsel for Appellee freely admitted in oral argument before the Supreme Court of South Carolina that were it not for the renting of the warehouse in South Carolina, it would not have sought to lay claim to taxes. In addition to the free admission by counsel, it is to be remembered that Appellee taxed extra-territorial sales, not local sales, by asserting that sales in states of the purchasers of Appellant's goods were not "*taxable*" there, when, as a matter of proof, the activities of the taxpayer in those states exceeded the mere solicitation of orders therein and were "*taxable*" sales therein as is clearly reflected in highest state court decisions dealing with Public Law 86-272, 15 U. S. C. 381.

CONCLUSION

Rule 16(d)(4) permits Appellant to file Brief in Opposition to Motion to Affirm or Dismiss. However, distribution of Jurisdictional Statement permits no time to Appellant after filing of Appellee's Motion in which to file Brief in Opposition. Therefore, this Brief is printed prior to filing of Appellee's Motion but any asserted basis for such Motion has been anticipated and the Motion is herein shown to be without merit and merely a perfunctory performance on the part of Appellee.

The Motion to Dismiss or Affirm should be denied because of constitutional and federal questions of patent importance under admitted, undisputed and proven facts on the part of Appellant.

Respectfully submitted,

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